Internal Revenue Service

memorandum

CC:TL
Br4:JTChalhoub

date: JAN - 9 1989

to: Special Trial Attorney
Midwest Regional Counsel CC:MW

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [redacted]

This is in response to your November 16, 1988 memorandum requesting technical advice concerning a proposed computation under Tax Ct. R. 155 with respect to previously refunded tentative allowances.

ISSUE

Under the facts of this case, will the bar of res judicata prevent the parties from later adjusting or contesting the amounts of tentative allowances for [redacted] and [redacted], which were partially allowed and partially disallowed in the notice of deficiency, if the parties failed to plead (assign error or claim increased deficiency), but specifically stipulate below the Judge's signature in the Tax Ct. R. 155 documents to reserve resolution of the correct allowances.

CONCLUSION

The bar of res judicata will apply because the excess tentative allowances were raised as an issue in the notice of deficiency. Tax Court Ct. R. 34(b)(4) states, in relevant part, as follows:

> Any issue not raised in the assignment of errors shall be deemed to be conceded.

Once an issue has been raised in the notice of deficiency or in the Tax Court, the decision document must reflect a resolution of that issue (whether litigated or settled) in the amount of deficiency (or overpayment) redetermined by the Tax Court. See also Sun Chemical Corp. v. United States, 218 Ct. Cl. 702 [78-2 USTC 9790] and 698 F.2d 1203 (Fed Cir. 1983) cert. den. 464 U.S. 819 (1983) [83-1 USTC 9170].

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This conclusion will be reconsidered after we meet with counsel for the taxpayer here in the National Office, pursuant to our reply to [redacted]'s ([redacted]'s) request for a conference in the event of an adverse ruling.

DISCUSSION

[redacted] received a notice of deficiency, dated [redacted], covering the tax years [redacted], [redacted], [redacted] and [redacted]. In the notice of deficiency, the computation of the deficiencies reflected a disallowed tentative allowance for the tax year [redacted] in the amount of $[redacted] and a disallowed tentative allowance for the tax year [redacted] in the amount of $[redacted]. Other issues covered by the notice of deficiency for [redacted] and [redacted] (and the other tax years) include two adjustments related to cost of goods sold. The [redacted] adjustment was tried by the parties and won by the respondent. The LIFO adjustment was settled and stipulated as agreed by the parties prior to trial. Other adjustments in the notice of deficiency were agreed to prior to issuance of the notice and the redetermined deficiency is expected to reflect all the adjustments agreed and not agreed in the Rule 155 computation. It is expected that [redacted] will file a notice of appeal at a future date with respect to its loss on the [redacted] issue. See T.C. Memo. 1988-111.

Prior to litigating the [redacted] issue, [redacted] did not allege in its petition any assignment of error with respect to disallowed tentative allowances for investment tax credits that were adjusted in the notice of deficiency. For the tax year [redacted], a tentative allowance was given [redacted] on [redacted] in the amount of $[redacted]. The notice of deficiency at Schedule 2, p. 3, states, in relevant part, as follows:

> (f) It has been determined that the corporation is entitled to a carry back Investment Tax Credit from [redacted] to [redacted] in the amount of $[redacted] rather than the $[redacted] shown in its application for a tentative refund filed [redacted].

There is at present no explanation in the work papers of the Appeals Officer or other schedules of the notice of deficiency in the administrative file for the difference between the ITC allowance made of $[redacted] and the allowance alleged to have been claimed in the notice of $[redacted] with respect to [redacted]. Accordingly, this discrepancy may be the result of a mathematical error.

With respect to [redacted], we are informed that [redacted] received two tentative allowances: (1) on [redacted] the amount of $[redacted] and (2) on [redacted] the amount of $[redacted], totalling $[redacted] that was recaptured in

the [redacted] notice of deficiency. We are unable to determine from the available documents you sent us, including a copy of the notice of deficiency, exactly what types of credits and the specific amounts thereof that were recaptured. However, we suspect the following statement from Schedule 2, p. 3, indicates a total disallowance of business type credits including the ITC credit:

> It has also been determined that the corporation is not entitled to the carryback of unused work incentive credit from [redacted] to [redacted] which was included in the above mentioned applications for tentative refund. Furthermore, the unused jobs credit carryback from [redacted] which was carried to [redacted] is not allowable. It has been determined that the corporation is entitled to a carryback of foreign tax credit from [redacted] to [redacted] in the amount of $[redacted]. The corporation has been allowed this carryback subject to the foreign tax credit limitation. The tentative allowance the corporation received in [sic] [redacted] due to a carryback of various credits from [redacted] has not been allowed.

In your request for technical advice you indicate that although the notice of deficiency totally disallowed the tentative allowance for [redacted], approximately [redacted] percent of that adjustment may be allowable. With respect to [redacted], the opposite result is probably correct. Although the notice of deficiency disallowed $[redacted] of the total tentative allowance of $[redacted], you now believe the respondent should have disallowed the entire $[redacted]. The remaining $[redacted] could be claimed as an increased deficiency if respondent were willing to assume the burden of proof. We do not believe you wish to assume that burden and have discounted that approach as a viable option.

We will refrain from discussing the various Code sections and law involving carrybacks and refer you to (and attach a copy of) our technical advice to the District Counsel, Hartford, dated October 21, 1981, relating to [redacted]. The facts in [redacted] were substantially identical to the facts in this case, except that [redacted] had pleaded in the petition that the Commissioner erred in disallowing the tentative allowance. On page 6 of that technical advice, in dictum, we stated:

> It is arguable, and we need not face the issue here, whether the exception [to res judicata in I.R.C. § 6511(d)(2)(B)(i)] could apply if the Service raised the question in the statutory notice, but the taxpayer failed to plead error with respect to such question and issue was not joined thereon in the Tax Court. In our view Tax Ct. R. 34(b)(4) would seem to merge the issue from the statutory notice into the general rule on res judicata and prohibit the exception under Code § 6511(d)(2)(B)(i) from applying.

The situation in [redacted] was similar to a situation that was litigated in Sun Chemical Corp. v. United States, 218 Ct. Cl. 702 (Ct. Cl. 1978) [78-2 USTC 9790]. [redacted] was attempting to do what Sun Chemical did, reserve for future litigation the merits of a carryback issue. The Federal Circuit said in its later opinion:

> The reason for the court's holding [78-2 USTC 9790] was that an earlier Tax Court judgment (based upon a compromise settlement) involving the 1961 tax year was res judicata for 1961, and therefore further litigation for this year was barred for all issues actually raised and issues that could have been presented.

Sun Chemical Corp. v. United States, 698 F.2d 1203 (Fed. Cir. 1983) cert. denied 464 U.S. 819 (1983) [83-1 USTC 9170].

Where, as here, the parties have raised the issue by disallowing the deduction in the statutory notice, any attempt to reserve or exclude the effect of the issue by stipulation, closing agreement or otherwise, will not meet the exception to a res judicata bar on subsequent litigation. In Bowman v. Commissioner, 17 T.C. 681,685 (1951) the Tax Court stated:

> Having unquestionably obtained jurisdiction for 1943, this Court may not be ousted from that status by action of the respondent nor deprived of its right to enter a final decision with respect to petitioner's tax liability for that year. A litigant in a matter before a court of competent jurisdiction who brings the other party into court is entitled to an ultimate judgment, and the opposing party cannot defeat the jurisdiction of the court by a waiver or disclaimer on his part.

If neither party, unilaterally, can oust the Tax Court of jurisdiction once acquired, both parties in concert by stipulation, closing agreement or otherwise cannot do so. By issuing the notice of deficiency, and disallowing the tentative

carryback allowances in that notice, the Commissioner as "a litigant in a matter before a court of competent jurisdiction who brings the other party into court is entitled to an ultimate judgment."

The difficulty here is that [redacted] failed to plead an issue or assign error as to a disallowance in the notice of deficiency. Neither party's trial counsel focused on the notice of deficiency insofar as it disallowed tentative allowances. The notice of deficiency included issues that had been agreed to by the parties before the notice was issued as well as issues that were disputed (SAJAC and LIFO). The stipulation before trial disposed of the LIFO issue, but failed to dispose of the disallowed carrybacks issue. Only when the Tax Ct. R. 155 computation was prepared did both sides realize they had an issue raised in the case that was not resolved by stipulation or trial.

Under Tax Ct. R. 155, the Court allows the parties in a computational setting only to carry out the result of their agreements (stipulations) and the result of matters that were tried. The rule does not authorize the parties to raise new issues, Harwood v. Commissioner, 83 T.C. 692, 695 (1984), Koufman v. Commissioner, T.C. Memo. 1977-225; or to reserve issues for future disposition. CCDM (35)10(62)(6) states, in relevant part, as follows:

> Once a carryback adjustment has been properly placed in issue in a Tax Court case, it is very questionable whether it can be removed from the case by an amended petition or even by agreement of the parties. Thus, in any case in which the carryback adjustment has been properly placed in issue and the taxpayer attempts to, or seeks to, withdraw it from the case, he should be informed that no assurance can be given that a carryback adjustment is thereafter allowable or will be allowed, unless disposed of by the decision in the instant case.

Finality is the result sought to be achieved. That result must be one of the following: (1) no deficiency and no overpayment, (2) a deficiency, (3) an overpayment, (4) a statutory deficiency, but net overpayment. Respondent may not issue a second notice of deficiency to recapture a tentative allowance not included in the first notice of deficiency. Midland Mortgage Co. v. Commissioner, 73 T.C. 902 (1980). However, respondent is permitted to recapture a tentative allowance not included in a prior notice of deficiency by making a summary assessment under I.R.C. § 6213(b)(3). See Rev. Rul. 88-88, 1988-41 I.R.B. 10.

Since [redacted] is inclined to appeal the [redacted] issue, and that issue is one of a continuing and substantial nature in future years, we believe [redacted] may wish to explore the suggested alternatives that we offered to [redacted]. Thus, litigation with respect to [redacted] and [redacted] is complete. The [redacted] issue is ripe for appeal. One alternative is to jointly move the Tax Court to sever the tax years [redacted] and [redacted] into a separately docketed case and to enter a decision that can be appealed for those years under Tax Ct. R. 155. Thus, T.C. Dkt. [redacted] may remain open until a final determination is made by the Service on the amount of tentative carryback allowances that are correctly allowed or finally agreed to by the parties. Then, a decision may be entered for [redacted] and [redacted] in that docket and [redacted] may appeal those years.

Another alternative is for the Service to formally make a § 6213(b)(3) summary assessment for [redacted] for the $[redacted] and collect that assessment from [redacted]. After collection, we would not object to the taxpayer, [redacted], amending the petition to claim an overpayment and to litigate or settle in the Tax Court the merits of all the tentative allowances. [redacted] would, of course, have the burden of proof on that issue. In connection with this alternative, we would have to ask the District Director, Indianapolis, and the Appeals Officer to accelerate audit and determination of the correct carrybacks allowable for each year.

In summary, we conclude that the parties are both at risk from the bar of res judicata, if the carryback years are allowed to go to final decision without resolution of the tentative allowance issue. Although not directly on point, the views of the Tax Court on the subject of res judicata, and its effect on litigation where a statute creates an exception for the fraud penalty, are very enlightening in the reviewed opinion in Zachim v. Commissioner, 91 T.C. No. 64 (December 6, 1988). The statutory exception for fraud was previously assumed to be very broad. However, the majority applied res judicata because the respondent "turned his back on the extended opportunity he had in the prior litigation to raise the fraud issue." (sl. op. 13). What we have here is a very narrow statutory exception to the bar of res judicata. I.R.C. § 6511(d)(4)(B). The issue was raised in the notice of deficiency and the parties are certainly aware of the existence of the issue before a decision is

entered. They are attempting to "turn their back" on the issue by deferring it to litigation or disposition at a future date. This type of deferral is precisely what the bar of res judicata as a rule of law is designed to prevent.

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By: Henry G. Salamy 1/12/83
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Attachment:
Copy of T/A to D.C. Hartford